No. 12,530

IN THE

United States Court of Appeals

For the Ninth Circuit

NICK W. MAROOSIS,
Appellant,

vs.

JAMES G. SMYTH, United States Collector of Internal Revenue,
Appellee.

Appeal from the United States District Court, Northern District of California, Southern Division.

BRIEF FOR APPELLANT.

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BRIEF FOR APPELLANT.

STATEMENT CONCERNING JURISDICTION.

The complaint of the appellant herein, filed June 22, 1949, in the United States District Court for the Northern District of California, Southern Division, alleges that this action arises under the Internal Revenue Laws of the United States (Tr. p. 2). The answer of the appellee admits the jurisdictional facts (Tr. p. 19).

Jurisdiction of the District Court is based upon Title 28, U.S.C.A., Section 1340, which provides:

> "The district courts shall have original jurisdiction of any civil action arising under any Act

> of Congress providing for internal revenue, or revenue from imports or tonnage except matters within the jurisdiction of the Customs Court. June 25, 1948, C. 646, 62 Stat. 932."

After trial before the Court on November 16 to 19, inclusive, 1949, and December 1, 1949, the Court rendered judgment on February 21, 1950, that the appellant take nothing from the appellee, and that appellant's complaint be dismissed (Tr. pp. 57-58). The judgment was filed on February 25, 1950 (Tr. p. 58).

The appellant, within sixty days from the date of the entry of final judgment, and on March 24. 1950, filed Notice of Appeal to the Circuit Court of Appeals for the Ninth Circuit (Tr. p. 60).

Thereafter, the record on appeal was filed and docketed in this Court on April 28, 1950 (Tr. pp. 307-309).

Jurisdiction of the United States Circuit Court of Appeals for the Ninth Circuit is based upon Title 28, U.S.C.A., Section 1291, which provides:

> "The courts of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States, * * * except where a direct review may be had in the Supreme Court."

STATEMENT OF THE CASE.

Appellant, as plaintiff below, brought this action to recover the primary assessment, the ad valorem

penalty and interest thereon paid appellee under protest. (Plaintiff's complaint, Tr. pp. 2-9, inclusive).

Appellee, as defendant below, by answer, put the major contentions of appellant at issue by his answer (Defendant's answer, Tr. pp. 19-22, inclusive).

Prior to April 1, 1944, appellant and a partner, Mike Kosloff, operated Joseph's, a liquor store at 458 Geary Street in San Francisco, California (Tr. p. 67).

The partnership was dissolved, and said dissolution was published (Tr. p. 68, Plaintiff's Exhibit 1, in evidence).

On April 1, 1944, appellant took sole possession of the Geary Street store (Tr. pp. 68, 69).

Appellant, on May 1, 1944, filed his liquor floor stock tax return for his Geary Street store in San Francisco (Plaintiff's complaint, Paragraph IV, Tr. p. 4; Defendant's answer, Paragraph IV, Tr. p. 20), based on an actual physical inventory taken by him as of April 1, 1944 (Tr. pp. 69, 70, 71, Plaintiff's Exhibit 2, in evidence).

Appellee's agents were, prior to April 1, 1944, suspicious of appellant. Because of this suspicion, appellee's agents spot checked the Geary Street store inventory on April 1, 1944 (Tr. pp. 235, 240).

On May 2, 1944, still because of this suspicion, appellee's agents took their own physical inventory of the Geary Street store (Tr. pp. 240, 241, Defendant's Exhibit B, in evidence). By adjusting for appel-

lant's purchases in said store from April 1, 1944, to May 2, 1944, and his sales for the same period, appellee's agents determined appellant's April 1, 1944, inventory (Tr. pp. 244, 245). This determination resulted in appellee's finding that appellant had *over-declared* his inventory in his return by some 108 proof gallons (Tr. p. 245).

Appellant explained this "over declaration" by pointing out that some sixty cases of whisky belonging to the Geary store inventory were stored elsewhere. These sixty cases wiped out the alleged overage (Tr. pp. 89, 90).

Appellee's agents were still suspicious, and *disregarded* appellant's physical inventory, *disregarded* their own "spot check" of April 1, 1944, and *disregarded* their own physical inventory taken May 2, 1944, as adjusted back to April 1, 1944.

By methods agreeable to everyone the appellee determined that between November 1, 1942, the date of a previous floor stock tax return, and March 31, 1944, appellant's starting inventory plus his purchases totaled 13,576.67 proof gallons of distilled spirits; that during the same period of time appellant's gross sales were $276,328.51. None of these figures are questioned by appellant.

If we disregard the previous actual inventories taken by the parties, how shall we determine what portion of the 13,576.67 proof gallons were sold by appellant between November 1, 1942, and March 31, 1944? Or: If we know that the gross sales between

November 1, 1942, and March 31, 1944, were $276,-328.51, then how are we to determine: (a) What percentage of the gross sales are distilled spirits sales? and (b) How are we to reduce the determined dollar sales of distilled spirits to proof gallons?

Appellee's agents, after determining that appellant's gross sales were $276,328.51 (which sum included sales tax) and that gross sales, exclusive of sales tax were $269,287.26 (Tr. p. 66), *asked appellant* what percentage of his gross sales were distilled spirits. Appellant gave two answers—at first *he said 66% and later said 86% of his gross sales were distilled spirits sales* (Tr. p. 253). Appellee accepted the *86%* figure and concluded that in dollar sales appellant sold $230,720.88 worth of distilled spirits between November 1, 1942, and March 31, 1944. Dividing this $230,720.88 by 20.93 (the *agreed* average selling price per proof gallon) appellee concluded that appellant had sold 11,023.46 proof gallons. This latter 11,023.46 proof gallon figure was then deducted from the 13,576.67 proof gallons on hand and purchased from November 1, 1942, to March 31, 1944, which left on hand as of April 1, 1944, 2,553.21 proof gallons. Appellant declared 1,330.36 proof gallons, which according to appellee's figures resulted in the alleged *under declaration of 1,222.85* proof gallons which is the basis of the assessment. (The statements in the preceding paragraphs not supported by specific citations to the record are contained in Paragraph VIII of plaintiff's complaint (Tr. p. 6), which is

admitted by defendant's answer, Paragraph VIII (Tr. p. 21).

We also note that Paragraph VIII of plaintiff's complaint alleges the addition by appellee of $76.19 to the basic calculations *"for which no explanation was furnished the taxpayer."* (Tr. p. 6). This $76.19 was added to the primary assessment and a 50% penalty was added to the primary assessment (Tr. p. 6) which increased this unexplained assessment to $117.29. All of this was *admitted* by appellee in defendant's answer, paragraph VIII (Tr. p. 21).

Appellant *sold* the Geary Street store on *May 25, 1944,* just twenty-three days after appellee took his physical inventory of appellant's store (Tr. p. 102).

On May 25, 1944, the State Board of Equalization of the State of California conducted an audit of the sales of distilled spirits of the store in question (Tr. pp. 103, 104, 105, copy of Audit, Plaintiff's Exhibit 21, in evidence).

This actual audit of the sales from appellant's books disclosed that the percentage of gross sales which constituted sales of distilled spirits was *96.41%* instead of 86% as estimated by the appellant (Plaintiff's Exhibit 21, in evidence, Exhibit A to plaintiff's complaint, Tr. p. 18).

On November 9, 1945, before the assessment in dispute was paid by appellant, a copy of the said State Board of Equalization audit which discloses on its face how the 96.41% figure was reached, was mailed to the Alcohol Tax Unit together with a letter of the same date (Plaintiff's Exhibit 26, in evidence).

Notwithstanding that appellee had a copy of said audit in his possession since November 9, 1945, appellee's agent testified that he never saw that audit *until two weeks before the trial,* (November 16, 1949). For four years said audit was in possession of appellee without being seen by the agent. Said agent admitted that he did not even check that audit to determine its correctness (Tr. p. 268).

SPECIFICATION OF ERRORS.

The Statement of Points on which appellant intends to rely on appeal was filed by attorneys for appellant on May 3, 1950, and is herein incorporated by reference (Tr. pp. 310-314).

We hereby restate our specification of errors for the purpose of clarity and expediency in presenting our argument.

1. The evidence is wholly insufficient to support the judgment because the evidence proves the assessment was arbitrary and excessive.

2. The evidence is wholly insufficient to support the judgment because the appellee's entire defense was founded upon irrelevant and unproved suspicions.

3. Finding of Fact III (Tr. p. 51) is in error in that there is no evidence to support a finding that two hundred cases of Three Rivers Whisky, or any cases of any whisky, were moved by appellant from a warehouse to an unknown destination, and the finding is wholly immaterial to the issues of this case.

4. Finding of Fact IV (Tr. p. 51) is in error in that there is no evidence to support the finding that appellee's physical inventory on May 2, 1944, did not include nor account for the said 200 cases of Three Rivers Whisky, nor the finding that said inventory did not include nor account for 100 cases of Three Rivers Whisky in the basement of a store at 499 Haight Street.

5. Finding of Fact VI (Tr. p. 52) is in error in that there is no evidence to support the finding that

(a) Neither the inventory taken by appellee on May 2, 1944, as adjusted to April 1, 1944, nor the inventory taken by appellant on April 1, 1944, was true or correct.

(b) Appellant's tax return of May 1, 1944, was false and incorrect.

(c) Use by appellee of said percentage of 86% was reasonable.

(d) Such method was the most reasonable and rational one available to appellee under the circumstances.

(e) Appellee had knowledge of the diversion of 200 cases of whisky.

(f) That appellee could have no confidence in any report by plaintiff.

6. Finding of Fact VII (Tr. p. 53) is in error in that there is no evidence to support the finding that appellant knowingly, intentionally, wilfully and deliberately concealed and failed to declare in his floor

tax return the said 200 cases or any cases of whisky removed from the warehouse on March 31, 1944.

7. Conclusion of Law I (Tr. p. 53) is in error in that appellee did not properly disregard appellant's written inventory of April 1, 1944, and appellee's inventory of May 2, 1944, as adjusted back to April 1, 1944.

8. Conclusion of Law II (Tr. p. 53) is in error in that appellee's determination of appellant's underdeclaration was not *reasonable.*

9. Conclusion of Law III (Tr. p. 53) is in error in that appellant has overcome the presumption that the assessment is accurate and proper.

10. Conclusion of Law IV (Tr. p. 53) is in error in that the tax return filed by appellant on May 1, 1944, was a true and correct one, and no basis exists in this case for the application of a fraud assessment, or, for that matter, a primary assessment.

11. The evidence is wholly insufficient to support in particular the judgment with regard to the fraud penalty because the burden of proof was upon appellee to establish fraud by clear and convincing evidence.

SUMMARY OF ARGUMENT.

The evidence clearly establishes that appellee's agent in computing the assessment in question relied on appellant's oral estimate that 86% of his gross sales were distilled spirits sales, whereas an actual audit of appellant's books disclosed that 96.41% of

appellant's gross sales were distilled spirits sales. The evidence further discloses that all of appellant's permanent books and records were in evidence before the Trial Court, that they are kept in a first-class manner, and that they reflect all the information necessary to an audit to determine the correct percentage of distilled spirits sales against gross sales. Such books were never audited by appellee. Nor did appellee ever check the State Board of Equalization Audit.

Appellant maintains that the use of 86%, a mere estimate by appellant, instead of the 96.41% figure reached by actual audit, is arbitrary.

The appellee stipulated that if 96.41% of the sales between July 1, 1943, and March 31, 1944, were distilled spirits sales, the assessment was in error, and yet upon proof that 96.41% of the sales during said period was distilled spirits sales, ceases to urge that 86% was the correct percentage, but instead urges the acceptance of 86% on the grounds that it is impossible to arrive at a correct computed inventory as of April 1, 1944. Appellee completely overlooks the fact that *he adopted the method of computing an inventory here in issue,* and his position that his own method is unsound is an attack *on his own assessment.*

Appellee adopted three methods of checking appellant's inventory: (1) His agents spot checked appellant's premises on April 1, 1944; (2) His agents took a physical inventory on May 2, 1944, and reconciled that inventory back to April 1, 1944; and (3) his agents made the computation here in issue. The

latter computation upon the substitution of the correct distilled spirits sales of 96.41% confirms appellant's inventory. The spot check and the May 2, 1944 inventory of appellee confirm appellant's inventory.

Faced with this, appellee contends that his own spot check and his own May 2, 1944 inventory are not accurate since they confirmed the appellant's inventory. And note he says that it is inaccurate because, in effect, he suspects he didn't count an unknown number of cases in an unknown place. The Trial Court sustained appellee's own erroneous computation here in issue because in his opinion a correct computation was impossible.

The appellee's entire position can be stated in one sentence: They suspect appellant made an incorrect return; they made an erroneous assessment based on incorrect data, based upon their suspicions; they now admit the assessment is erroneous, but they ask the Court to sustain it on the basis that no correct assessment can be made because if the Court sustains this assessment, then it will, in turn, confirm their unproved suspicions.

Whereas, the Trial Court finds that on March 31, 1944, appellant concealed some two hundred cases of whisky (which contain 412.8 proof gallons of distilled spirits), he sustained a claimed understatement of 1222.85 proof gallons.

Appellant contends with reference to the foregoing: First, that there is no evidence to support such a finding; second, that even if there were a concealment on March 31, 1944, that would not tend to estab-

lish a failure to include said distilled spirits in a return filed May 1, 1944, showing distilled spirits on hand as of April 1, 1944; third, if two hundred cases or 412.8 proof gallons were under-declared, then why sustain a contention that 1222.85 proof gallons were under-declared?

Appellee's sole allegation in his pleadings as to the reason he disregarded appellant's physical inventory upon which his return was computed, and appellee's own physical inventory can be noted from plaintiff's complaint, paragraph VI (Tr. pp. 4, 5) which was admitted in defendant's answer, paragraph VI (Tr. p. 20). There appellee alleges that the differences in the quantity of distilled spirits computed by appellee's agents "was caused by errors and omissions in the records kept by plaintiff at his place of business" (Defendant's Answer, paragraph VI, Tr. p. 20). How then can the Trial Court, without finding either for or against such an allegation, find, instead, in effect that such differences in quantity were occasioned by a concealment of two hundred cases of whisky which finding of concealment is, in turn, not supported by the evidence?

Various Findings of Fact of the Trial Court are erroneous, not based on the evidence and not supported by the evidence and in certain instances are contrary to the evidence. Such Findings of Fact are III, IV, VI and VII. Finding of Fact VII legislates a penalty greater than that imposed by law.

Appellant has sustained the burden of proof by a preponderance of evidence that the primary assess-

ment levied against him is illegal. On the other hand, appellee has failed to meet the burden of proof in his attempt to prove fraud by clear and convincing evidence.

I. THE ASSESSMENT WAS ARBITRARY AND EXCESSIVE.

From the allegations contained in paragraph VIII of plaintiff's complaint (Tr. p. 6) all of which are admitted by paragraph VIII of defendant's answer (Tr. p. 21) we must conclude that the alleged shortage constituting the basis of the assessment here in question was determined by appellee by the use of appellant's estimate that *86% of his total gross sales was distilled spirits sales.*

Is this 86% figure correct?

The basic problem in this case is as simple as that in so far as the correctness of the assessment is concerned.

If appellant has proved by a preponderance of the evidence that his own estimate of 86% is erroneous and too low, then he has proved that the assessment is arbitrary and excessive and therefore illegal.

A. The Acceptance of the 86% Estimate as the Correct Percentage of Distilled Spirits Sales Against Gross Sales Is Arbitrary.

Appellee's agent Hedrick admitted that he *made no check of appellant's 86% estimate* and admitted that if this estimate was wrong, *then the entire assessment was wrong.*

In this respect appellee's agent Hedrick testified as follows:

> "Q. You made no other check other than the acceptance of that figure, did you—no other check than acceptance of that figure from Mr. Maroosis, 86 per cent?
>
> A. No, I don't think we did.
>
> Q. If that figure is incorrect or an improper estimate made by Mr. Maroosis, then your assessment is to that extent in error, is that correct?
>
> A. That's right." (Tr. p. 273).

Mr. Hedrick also testified that he did not think he made any other check to determine the correctness of his estimated inventory either as against his own physical inventory of May 2, 1944, or against appellant's inventory as of April 1, 1944, other than by the use of this 86% estimate supplied by appellant (Tr. p. 273).

The acceptance of the appellant's 86% estimate by the appellee's agent is not the normal usual course adopted by revenue agents.

The Court will recall that the appellant at first estimated his percentage of distilled spirits sales against gross sales to be 66% and later in that same conversation changed it to 86% (Tr. pp. 252-53).

Nothing could be more pointed to support the appellant's contention that the acceptance of the 86% figure is arbitrary and dependent upon the whim of the agent, than the remarks of the Trial Court in his summation at the conclusion of the case.

In this regard, the Trial Court stated:

> "It is difficult for me to see how the plaintiff can contend the 86% is unreasonable when he was the one that gave the figure. In using the figure 86%, Mr. Hedrick inclined as strongly as he could toward the plaintiff. Had he used 66%, the shortage would have been tremendously greater." (Tr. p. 303).

In effect, the Trial Court says: that the appellant is a lucky man, because by the whim of the agent, and in his arbitrary attitude, the agent chose to accept the 86% figure instead of the 66% figure. And the Trial Court indicates further that the agent could have properly accepted either one of the two figures (Tr. p. 303). The very fact that the agent could have, at his sole whim and caprice, chosen either one of the figures as the basis for his determination, and by so doing, had he chosen the 66% figure, assessed the taxpayer additional tax and penalties of $11,794.50, plus interest, indicates the utter disregard of a taxpayer's rights when subjected to the arbitrary actions of the assessing agent.

B. The Appellant's Books and Records Are in Order and Fully Disclose All Information Needed to Determine the Correctness of Appellant's April 1, 1944 Physical Inventory.

The appellee's agent himself *admits* that his own computation of liquor on hand in appellant's store, (which is the basis of the assessment) *is incorrect* (Tr. p. 271).

Though appellee's agent Hedrick made the unwarranted statement that from the appellant's books

he did not "believe" (note: the word "believe" as distinguished from actual knowledge) that it was possible to ascertain a true inventory as of April 1, 1944 (Tr. p. 255); he admitted that when he made the final assessment he relied on four basic figures: (1) Appellant's opening inventory of November 1, 1942; (2) Appellant's gross purchases from November 1, 1942 to March 31, 1944; (3) Appellant's gross sales; and (4) Appellant's estimate that 86% of his gross sales were sales of distilled spirits (Tr. pp. 264, 265).

Agent Hedrick admitted he accepted appellant's book figures for his opening inventory (Tr. p. 264). He testified that he verified appellant's purchases through "every wholesaler," and in so doing he determined that appellant's purchases, as checked by him, were $41.00 *less* than those reflected in appellant's books (Tr. pp. 265, 266). He admitted that on checking the wholesalers' records he could have missed one invoice (Tr. p. 266). He admitted that he "verified Mr. Maroosis' purchase figure as substantially correct" (Tr. p. 266). He admitted that he accepted appellant's book "figure" of his gross sales.

We therefore find that of the four basic figures used by appellee, the three that could be lifted bodily from appellant's books were accepted or verified by appellee. The only figure used by appellee not in the books was appellant's 86% estimate.

Why then appellee's agent testified that from appellant's books he did not "believe" a true inventory

as of April 1, 1944, could be ascertained (Tr. p. 255) is left to pure speculation.

On direct examination, the agent Hedrick admitted that the computation made by *appellee* was inaccurate; *that he did not believe its accuracy,* but made the unwarranted statement that from the appellant's records it was not possible to ascertain a true and correct inventory as of April 1, 1944 (Tr. p. 255).

Yet, on cross-examination, this very same agent when questioned relative to what records the average liquor dealer had which the appellant did not have in his bookkeeping system, answered:

> "I was getting cross up. I have made a thorough investigation or thorough investigation *only of this particular liquor store.* The other floor stock tax investigations that I made resulted in no complications that involved searching investigations. *I am unprepared to state from experience such as you have mentioned whether his records are more or less complete than other stores."** (Tr. p. 272).

The Court will note that the agent Hedrick was never qualified by the appellee as an accountant, nor was any accountant or expert in accountancy called as a witness for the appellee.

On the other hand we have heretofore pointed out that the State Board of Equalization audit was delivered to appellee on Nov. 9, 1945 (Plaintiff's Ex. 26); that appellee never even examined that audit

*All emphasis herein are appellant's unless otherwise stated.

until two weeks before the trial (Tr. p. 268); that appellee admitted he never checked that audit (Tr. p. 268).

Yet the appellee's agent, without checking the audit, proceeds to attack it with the following bit of spicy logic:

> "A. That refers exactly right back to my last previous answer, if we assume that the receipts in the bank deposits of Mr. Maroosis are representative of distilled spirits sold, the selling price in the audit *should be correct.* And I would answer that I can not." (Tr. p. 268).

The fact is that *there is not one iota of evidence* in this record that any proceeds from the sales of appellant were not deposited to his bank account. In fact Mr. Hedrick boldly admits he cannot disprove the fact that all the sale proceeds went into appellant's bank account. And he accepts that as a fact. Mr. Hedrick testified:

> "Q. That is you couldn't disprove it; is that what you mean?
>
> A. That is a question that is a little bit hard to answer. No, I have no way of disproving the fact that he received the amount of money, 276 and something, *and put that money in the bank. We accept that, that the money did go in the bank* but *I* do not accept that it represents merchandise sold at $20.93 a proof gallon, which is the correct selling price." (Tr. p. 269).

Another example of an unsupported and irresponsible statement "*I* do not accept".

A Certified Public Accountant, J. Bruck, was called as a witness by appellant. His qualifications as a Certified Public Accountant were accepted by the attorney for the appellee (Tr. p. 164).

He testified that appellant kept a double entry set of books which in his opinion were complete and properly kept, and that from an examination of the records of the appellant, *he could determine the appellant's purchases, sales and his inventory as of* a given period (Tr. p. 165).

He further testified that he reviewed the method by which the State Board of Equalization arrived at the 96.41% percentage of distilled spirits sales, and that their computations were in order and in the witness' opinion, were substantially correct (Tr. p. 171); *that his check showed the correctness of said audit* (Tr. p. 172).

The witness Bruck further testified that the permanent records of the appellant were in evidence in this case as Plaintiff's Exhibit 14 (Tr. p. 181) and Plaintiff's Exhibit 17 (Tr. p. 205). There is no evidence in the record to even contradict Mr. Bruck's testimony as above set out.

C. 96.41% Is the Correct Percentage of Distilled Spirits Sales Against Gross Sales.

In referring to the State Board of Equalization audit (Plaintiff's Exhibit 21), we respectfully request that this Honorable Court refer to the Retail Distilled Spirits License Fee Audit Report, annexed

to the complaint filed in this action as Exhibit A thereto (Tr. pp. 18-19).

We call the Court's attention to the fact, that in appellee's answer, the receipt of this document by the appellee is admitted (Defendant's Answer, paragraph XI, Tr. p. 21).

An examination of the Retail Distilled Spirits License Fee Audit Report (Tr. pp. 18 and 19) discloses the following questions and answers on the report itself, which are pertinent to the issues here:

> "1. What method was used to arrive at audited sales? Cost of sales plus gross profit plus sales tax.
>
> 2. If on cost plus mark-up basis:
>
> A. What percentage of mark-up was used? (33⅓).
>
> B. Were inventory fluctuations considered? Yes.
>
> * * * * * * *
>
> 6. Audited Distilled Spirits *sales are 96.41% of gross sales.*" (Tr. p. 18).

In determining the significance of the above quoted portions of the State Board of Equalization Report, we respectfully call to the Court's attention, the testimony of the agent Hedrick, heretofore referred to and quoted in this brief.

Appellee's agent stated in effect that it was his contention that the sales of the appellant did not represent sales of distilled spirits at ceiling prices (Tr. p. 269).

He furthermore stated, "I do not accept that it represents merchandise sold at $20.93 a proof gallon, which is the correct selling price." (Tr. p. 269).

When we examine questions 1 and 2 and the answers thereto, above quoted from the Retail Distilled Spirits License Fee Audit Report (Tr. p. 18), we find that the State Board in determining distilled spirits sales used the 33⅓% mark-up accepted by all of the parties to this action.

Appellant feels that the Trial Court was under the misapprehension that the 96.41 percentage figure was arbitrarily determined and then applied against the total sales to arrive at the distilled spirits sales. Actually, the State Board of Equalization made a determination of the *distilled spirits sales at ceiling* prices (using the 33⅓% mark-up on cost of sales as accepted by all parties to this action). The 96.41% figure was then determined by dividing the total sales taken from the plaintiff's permanent records into the distilled spirits sales determined by the Board from appellant's books.

As can be noted from page 1 of the State Board of Equalization Audit (Plaintiff's Exhibit 21), they first determined the cost of goods sold for the period between July 1, 1943, and May 25, 1944. The State Board added the opening distilled spirits inventory of June 30, 1943, of $5,912.24 to the purchase figure of $174,722.73. The State Board then subtracted the distilled spirits inventory on May 25, 1944. Next the State Board added $3,991.09 representing the floor tax paid on the distilled spirits inventory of April 1, 1944.

The resultant figure is the cost of distilled spirits sold during the period in question. The State Board then added $55,282.86, which was 33⅓% of the cost of sales, and when added to the cost of sales, resulted in the distilled spirits sales at ceiling prices. The State Board then added $5,528.29, representing sales tax at 2½% on said sales, to arrive at $226,659.99 distilled spirits sales for the entire period (Plaintiff's Exhibit 21, in evidence).

The $226,659.99 distilled spirits sales were segregated into quarters by the State Board of Equalization in the following manner:

For the quarter ended September 30, 1943	$26,413.23
For the quarter ended December 31, 1943	$87,890.50
For the quarter ended March 31, 1944	$90,722.53
For the quarter ended June 30, 1944	$21,631.95

(Exhibit A to plaintiff's complaint, Tr. p. 18).

The period, however, that is in issue here is July 1, 1943, to March 31, 1944. Let us therefore add the distilled spirits sales for the first three quarters listed above. The total of these three figures is $205,025.91. This figure includes sales tax. The sales tax rate was 2½% and the sales tax included in said figure was therefore $5,000.63. When we subtract the sales tax figure from the $205,025.91, we arrive at the distilled spirits sales, exclusive of sales tax for the period July 1, 1943, to March 31, 1944, in the amount $200,025.68.

The gross sales exclusive of sales tax as reflected by the appellant's books between the dates of July 1, 1943 to March 31, 1944 were $207,473.58 (Stipulation paragraph 2, Tr. p. 27). The division of this sum into the audited distilled spirits sales of $200,025.68 results

in the *96.41%,* the correct percentage of distilled spirits sales against gross sales.

It is interesting to note that the Retail Distilled Spirits License Fee Audit Reports of the State Board of Equalization (Tr. pp. 18-19), has, over the signature of the State Board of Equalization auditor, his report which contains the following statement:

> "1. Method used by licensee to arrive at reported sales:
> Reported sales were 60-86% of total sales" (Tr. of record p. 19).

The significance of the foregoing quotation is that it corroborates the appellant's own estimate of his distilled spirits sales against total sales as given by him to the agent Hedrick. It establishes that the licensee, the appellant herein, reported to the State Board of Equalization that his distilled spirits sales was 60 to 86% of total sales. That was his opinion, but the State Board of Equalization, notwithstanding that opinion of the appellant, proceeded to conduct its own audit, and determined that the appellant's estimate of 60 to 86% *was incorrect* and that *96.41% was the correct percentage* of distilled spirits sales against gross sales.

Also significant in the report of the State Board of Equalization auditor, is the following:

> "Records
>
> 1. Do records meet requirements of section 24.4 of the Alcoholic Beverage Control Act and the Rules and Regulations issued thereunder?
> Yes." (Tr. p. 19).

From the foregoing quotation, it could only be inferred that the records of the appellant were such as are required by the law, from which records could be determined, the percentage of distilled spirits sales against gross sales.

In the face of the foregoing, for the appellee, throughout the negotiations between the parties prior to the trial of this action and during the trial, to have steadfastly maintained that the 86% estimate given by the appellant was the proper estimate to use is an argument bordering on the facetious.

Where the actual records of the appellant as hereinabove set forth, and the audit of the State Board of Equalization determine that 96.41% was the proper percentage of distilled spirits sales against gross sales, to arbitrarily refuse to accept such figure, without even checking said audit, or making its own audit, compels us to the conclusion that the action of the appellee is arbitrary, capricious and dependent upon the whim of the investigating agent.

D. By Stipulation Appellee, in Effect, Admits That His Assessment Is Erroneous.

A written stipulation between counsel was entered into and made a part of the record in this case, which stipulation is set forth on pages 26 to 29, inc. of the Transcript.

Paragraph 4 of the stipulation provides that if 96.41% is the correct percentage of distilled spirits sales to total sales between the period of July 1, 1943 to March 31, 1944, the distilled spirits sales would be $200,025.28. This stipulation is as follows:

> "That if the Court finds from the evidence that 96.41 per cent of the gross sales between the period of July 1, 1943, to March 31, 1944, were sales of distilled spirits that the sales of distilled spirits for the period from July 1, 1943 to March 31, 1944, would be $200,025.28." (Tr. p. 27).

Paragraph 6 of said stipulation provides that if the selling price per proof gallon was $20.93, the total of distilled spirits sales would then be 12,096.75 proof gallons instead of the 11,023.46 proof gallons listed in the assessment (Tr. p. 28).

This would result in a reduction of 1,073.29 proof gallons in the appellee's calculated understatement (Paragraph 8 of Stipulation-Transcript p. 28) and would reduce that calculated understatement to 149.56 proof gallons (Paragraph 11 of Stipulation-Transcript pp. 28-29). Such an alleged understatement of 149.56 proof gallons, as provided in paragraph 12 of said stipulation, *would confirm the physical inventory taken by the appellant,* since it was stipulated in Paragraph 12 that an understatement or overstatement of approximately 1% of proof gallons purchased or sold during a given period based on a percentage calculation, *is sufficient to confirm a physical inventory* (Tr. p. 29).

(The selling price per proof gallon, $20.93, was computed by the appellee's agent by adding 33⅓% to the 15.695 cost price per proof gallon. 33⅓% was the average OPA mark-up. These figures have been accepted throughout by both parties.)

This stipulation can be summarized very briefly, as follows:

If 96.41% (the State Board of Equalization figure) of the total sales between July 1, 1943, and March 1, 1944 (an amount of $200,025.28) were distilled spirits sales, *then the entire assessment here in question is in error* and the inventory of appellant as of April 1, 1944, upon which the original return was based, *is accurate.*

The audit of the State Board of Equalization shows that the distilled spirits sales for said period were $200,025.68, or 40¢ in excess of the stipulated figure (Written Stipulation Tr. p. 27).

The determination of distilled spirits sales by the State Board of Equalization was obviously determined at ceiling prices since the State Board of Equalization first determined the actual cost of sales, and added thereto 33⅓% (the accepted OPA mark-up). It must follow that the figures necessary to prove the appellant's inventory and eliminate the entire assessment have been established by the audit of the State Board of Equalization, as reviewed by appellant's Certified Public Accountant (Tr. pp. 171, 172, 173) and admittedly never even checked by appellant (Tr. p. 268).

There has never been any question but that the appellant's books correctly stated the cost of goods sold. The Alcohol Tax Unit audited all purchases by examination of invoices in the files of wholesalers, and arrived at a purchase figure $41.00 less than that shown by the appellant's books, and the appellee's

agent admitted that he could have missed an invoice which would have accounted for the $41.00 (Tr. pp. 251 and 265). The cost of sales figures used in the State Board of Equalization audit have been taken from the books of appellant. (Schedule 1 (appendix) shows how the cost of sales figures were taken from the books of appellant).

E. Appellee Contends He Is Incapable of Calculating a True and Correct Inventory as of April 1, 1944. Therefore, Appellee Contends, in Effect, That Judgment Must Be For the Appellant.

Appellee offers a novel defense to the assessment when he contends that it is not possible, from the records in evidence, to ascertain a true and correct inventory as of April 1, 1944 (Tr. p. 255). Section 308 of the "Revenue Act of 1943" and the regulations thereunder required appellant to file a return based on an *actual physical inventory.* The appellee seeks to prove that the physical inventory was inaccurate, and in order to do so calculated his own *computed inventory.* If the appellee believes that its computed inventory is incorrect and that it is not possible to determine a computed inventory as of April 1, 1944, then by its own admission the *method adopted by the appellee to check the physical inventory* of the appellant *is not a proper method* and should be abandoned. It *must be remembered that the computed inventory is being offered in this case by the appellee and not by the appellant.* We have already discussed the value of appellee's testimony with regard to appellant's records.

II. APPELLEE'S ENTIRE DEFENSE FOUNDED UPON IRRELEVANT AND UNPROVED SUSPICIONS.

Earlier in this brief appellants referred to the "suspicions" of the appellee's agents which resulted in their spot checking the Geary Street store on April 1, 1944, and their taking their own physical inventory of said store on May 2, 1944.

A. The Truck Movements Fail to Establish the Concealment of Any Whisky.

The "basis" for this suspicion is set forth in agent Hedrick's testimony contained in the Transcript pp. 246 to 250, in effect as follows:

On *March 31, 1944,* from 11:20 A. M. to 11 P. M. two of appellee's agents followed two trucks. One removed certain cartons "resembling whisky cartons" from a warehouse (Tr. p. 246). A panel truck was met in a garage and some "cartons" were transferred to it (Tr. p. 247). The agents saw "something" in the panel truck covered with a blanket (Tr. p. 247). The panel truck was followed to a residence garage on San Bruno Avenue in San Francisco and disappeared therein (Tr. pp. 247, 248).

The Court admitted in evidence an affidavit of Mr. Dellari, owner of the San Bruno property (Tr. p. 295). The Trial Court believed the statements in the affidavit of Dellari (Tr. p. 304). Dellari stated he knew of no whisky stored in his garage and so told appellee's agents who questioned him.

The large truck was followed to two of appellant's stores (Tr. pp. 248, 249). At one some cartons were

unloaded (Tr. p. 248). At another some were loaded on the truck (Tr. p. 249). At 11 P. M. (still March 31, 1944) they lost the truck in the traffic and did not see it again (Tr. p. 249).

The witness then stated, referring to the movements of these trucks, "That is the basis for my suspicions of the inventory as furnished by Mr. Maroosis for the store at 458 Geary Street. Suspected it was not correct" (Tr. p. 249).

Even though appellant is of the opinion that the foregoing recitation of alleged movements of liquor is far from sufficient to prove any concealment, we respectfully submit that such testimony was properly objected to by appellant and said objections were improperly overruled (Tr. p. 245).

It will be noted:

That the alleged activities of the truck were all *before* April 1, 1944, to-wit, March 31, 1944;

That not one iota of evidence was introduced which tends to establish that any liquor was stored anywhere other than at appellant's stores;

That not one bit of evidence was introduced that tended to establish that the appellee's agents actually saw or claim to have seen even one case of Three Rivers Whisky, or any other whisky, either in a truck or concealed anywhere.

Yet the Trial Court found that "on March 31, 1944, 200 cases of Three Rivers Whisky floor stock of said store at 458 Geary Street were moved by plaintiff

from a warehouse to an unknown destination" (Finding of Fact No. III, Tr. p. 51).

There is no evidence to sustain this finding.

Agent Hedrick did not mention the number "200" nor any number in his testimony relative to the truck movements.

But even if that finding were sustained by the evidence we are not here concerned with either the alleged movement or concealment of liquor for any time *either prior to,* or *subsequent to,* April 1, 1944. We are here concerned only with whether or not on April 1, 1944, appellant made a correct Floor Stock Tax Return. Regardless of any "suspicious" activities prior to April 1, 1944, what evidence is there that 200 cases of Three Rivers Whisky, or even one case, was concealed on April 1, 1944? We respectfully submit there is none.

B. No Three Rivers Whisky Was Concealed; All on Hand Was Declared; Mathematically It Is Proved None Could Have Been Concealed.

Appellee's agent Hedrick admitted that he and others spot checked the inventory at the Geary Street store on April 1, 1944 (Tr. pp. 235, 240). Appellee admitted taking an actual physical inventory of the Geary Street store on May 2, 1944 (Defendant's Exhibit B, in evidence, Tr. p. 240).

Appellant introduced in evidence the inventory and recap sheets of both the Geary Street store (Plaintiff's Exhibit 2, in evidence) and the Haight Street store (Plaintiff's Exhibits 3 and 4, in evidence). The

latter were brought into this case to explain the "suspicious" movement of liquor. Because of lack of storage space in the Geary Street store, appellant explained that 100 cases of Three Rivers Whisky were stored in the basement of the Haight Street store (Tr. pp. 78, 79, 80).

For a proper evaluation of these inventories we explain that Plaintiff's Exhibit 3 is the Haight Street store actual penciled inventory (Tr. p. 77). Plaintiff's Exhibit 4 is a "recap" of Plaintiff's Exhibit 3 (Tr. p. 82). Plaintiff's Exhibit 2, it will be noted, has two sections. One consists of penciled sheets, the other section is typed sheets. The penciled sheets are the actual inventory of the Geary Street store (Tr. pp. 69, 70). The typed sheets are a "recap" of the Geary Street store inventory (Tr. p. 77).

Plaintiff's Exhibit 3, the Haight Street store inventory discloses that 100 cases of Three Rivers Whisky were physically at the Haight Street store. The typed portion of Plaintiff's Exhibit 2 shows that *this 100 cases was figured as part of the inventory* of the Geary Street store. In substantiation of the foregoing, an examination of the Plaintiff's Exhibits 2, 3 and 4 discloses the following with reference to this 100 cases of Three Rivers Whisky:

The *penciled* inventory of the Geary Street store contains these references to Three Rivers Whisky:

At	pages	33.....	2 Fifths
"	"	36.....	2 "
"	"	36.....	163 Cases
"	"	37.....	8 "

(Plaintiff's Exhibit 2 in evidence). These items total 171 cases and four bottles, or 171⅓ cases of Three Rivers Whisky.

An examination of the penciled inventory of the Haight Street store (Plaintiff's Exhibit 3 in evidence) discloses on page 9, 100 cases of Three Rivers Whisky. An examination of Plaintiff's Exhibit 4 (the recap of the Haight Street inventory), discloses that *there is no* Three Rivers Whisky listed therein. However, an examination of the "recap" of the Geary Street store inventory (typed sheets of Plaintiff's Exhibit 2), discloses, on page 10, *3,256* bottles of Three Rivers Whisky, which reduced to cases by dividing said number by twelve, equals 271⅓ cases.

The Court will therefore note that the penciled inventory of the Geary Street store contains only 171⅓ cases of Three Rivers Whisky, while the recap sheets of the Geary Street store contain 271⅓ cases of Three Rivers Whisky. On the other hand, the penciled inventory of the Haight Street store disclosed the presence in that store of the 100 cases of Three Rivers Whisky, but the recap of the Haight Street store inventory contains *no* Three Rivers Whisky. Hence, since these 100 cases actually belonged to the Geary Street store, but were physically in the Haight Street store, and since the return in question was prepared by the appellant from his recap sheets, it is obvious that the floor stock tax on these 100 cases was paid (Tr. pp. 76-77). *Where they were located is entirely irrelevant to these issues.*

That the agent was aware that the Geary Street store had 100 cases of Three Rivers Whisky which were physically in the Haight Street store is beyond question.

Agent Hedrick admitted that on May 2, 1944 (this was the day that the agents took their own physical inventory of the Geary Street store, as evidenced by Defendant's Exhibit B) appellant handed to him and *he, Hedrick, receipted therefor,* a list containing 231 serial numbers representing 231 cases of Three Rivers Whisky at the Geary Street store as of April 1, 1944 (Tr. p. 257; Plaintiff's Exhibit 31, in evidence).

It is quite obvious that since the penciled inventory of the Geary Street store (Plaintiff's Exhibit 2) as of April 1, 1944, listed only 171⅓ cases of Three Rivers Whisky, when Hedrick was furnished with a list of 231 full cases (this aside from broken case lots), he could only conclude that there must have been some Three Rivers Whisky belonging to the Geary Street store which were located somewhere else. As an agent of appellee seeking to establish an under-declaration he had a duty to investigate to determine the reason for this phenomenon.

In this regard, the appellant himself testified that when said agents took their own physical inventory and checked it back, they found appellant's return *over-declared* his liquor inventory by 108 proof gallons (Tr. p. 245).

Even though such an over-declaration benefits the appellant, he explained that he had on hand in the

Haight Street store on May 2, 1944, 60 of the original 100 cases, 40 having been moved between April 1, 1944, and May 2, 1944. These are 86 proof, which when reduced to proof gallons completely wiped out the alleged 108 proof gallon over-declaration (Tr. p. 91).

To further exemplify the danger of reliance upon suspicion and conjecture in a case of this kind, we point out that the assessment in question here covers an approximate shortage of over 1222 proof gallons, whereas the Court found only 200 cases of Three Rivers Whisky had been concealed (Finding No. III, Tr. p. 51). 200 cases, being 86 proof, when reduced to proof gallons is *412.8* proof gallons. But the assessment charges appellant with a shortage of 1222.85 proof gallons, or approximately 600 cases. The total Three Rivers Whisky purchased by the appellant was 775 cases (Tr. p. 246). He reported 271⅓ cases on hand April 1, 1944, but he is in effect being charged with a shortage of 600 cases. This 600-case alleged shortage, plus the 271⅓ cases reported, total 871⅓ cases. Without allowing for the sale of any of this whisky during the latter part of February and all of March, 1944, the Trial Court in effect found he had on hand more Three Rivers Whisky than he ever purchased.

C. Alleged Black Market Activities Are Neither Founded on the Evidence Nor Are They Material to These Issues.

At various points in the testimony and in the statements of counsel for appellee references were made to so-called "black market operations".

When appellee's counsel questioned agent Hedrick relative to the results of his black market investigations, counsel for appellant objected on the ground that such activities were irrelevant, which objection was overruled (Tr. p. 233). Appellant still cannot see the relevancy of such testimony.

With reference to these alleged "black market operations", agent Hedrick testified that in investigating black market sales *in December of 1943,* he investigated appellant's store; that information concerning black market liquor was very difficult to obtain; and that although he "tried to trace the sale back to Mr. Maroosis, and it was almost impossible to obtain evidence of the direct sale by Mr. Maroosis—I say Mr. Maroosis, I mean the store at 458 Geary Street known as Joseph's, but which was often associated with Mr. Maroosis as being the manager, or operator" (Tr. p. 234).

Another witness for the appellee, George Harer, testified (again over the objection of appellant (Tr. p. 282), which objection appellant believes was well taken), that in December, 1943, certain books of the appellant intimated that certain sales were over ceiling, stating that from his recollection the appellant's books showed the sales of Ramshead Whisky which ranged from $57.00 to $65.00 a case (Tr. p. 281). He also testified that the cost of this whisky was $29.79, "if I recall correctly" (Tr. p. 282).

No documentary evidence as to sales or costs were introduced by the appellee.

On cross-examination, however, Mr. Harer testified:

"Q. Now, Mr. Harer, what was the ceiling price of Ramshead whiskey.

A. Ceiling prices?

Q. Yes.

A. When?

Q. In December of 1943.

A. I don't know." (Tr. 285).

There is no evidence which sustains any contention that appellant was engaged in black market activities.

III. THE FINDINGS OF FACT OF THE TRIAL COURT ARE ERRONEOUS, NOT BASED ON THE EVIDENCE, NOT SUPPORTED BY THE EVIDENCE, AND ARE CONTRARY TO THE EVIDENCE.

A. Finding of Fact III Is Unsupported by the Evidence and Is Wholly Immaterial to the Issues of This Case.

Finding of Fact No. III (Tr. p. 51), that 200 cases of Three Rivers Whiskey were on March 31, 1944 moved to an unknown destination, has already been fully covered. The testimony of the alleged movement of the liquor fails to identify one carton as whiskey—let alone Three Rivers Whiskey (Tr. pp. 246 to 250); it fails to establish that even one case was concealed or undeclared.

Then the fact, if it be such, that such movement was made on March 31, 1944 fails utterly to establish that any whiskey allegedly moved was not declared in the return filed on May 1, 1944.

B. Finding of Fact No. IV Is Contrary to Evidence Offered by Appellee and Undisputed by Appellant.

In Finding of Fact No. IV (Tr. p. 51) the Court finds: (a) that the May 2, 1944 inventory taken by appellee's agents, as adjusted back to April 1, 1944 did not account for the said 200 cases of Three Rivers Whiskey; and (b) that said inventory did not take into account the 100 cases stored at the Haight Street store. Appellant has hereinabove covered these points.

We cannot overlook the inescapable conclusion that the 100 cases of Three Rivers Whiskey were fully accounted for in the process of adjusting the appellee's May 2, 1944 inventory back for the comparison with appellant's April 1, 1944 inventory which fully listed the 100 cases in the Haight Street store (typed sheets of Plaintiff's Exhibit 2, in evidence).

From a reading of the pleadings it will be noted that *at no time before the trial did appellee* contend that appellant's alleged underdeclaration in his return was occasioned by any concealment of whiskey. To the contrary, it was contended that it was caused "by errors and omissions in the records kept by the plaintiff at his place of business" (Defendant's Answer Par. VI, Tr. p. 20).

Nowhere in the Defendant's Answer does there appear any allegation of the concealment of any whiskey (Defendant's Answer, Tr. pp. 19, 20, 21 and 22). Concealment of whiskey was not an issue before the Trial Court.

Plaintiff's Exhibit 7 in evidence is a letter received by appellant from S. H. Maloney, District Supervisor of the Alcohol Tax Unit prior to the payment of the assessment in issue. Pertinent excerpts from this letter are contained in Schedule II—Appendix.

In this letter, the Alcohol Tax Unit supports the fraud penalty on the basis of the *amount* of the alleged underdeclaration. *There is no reference whatever to the concealment of whiskey.* The Alcohol Tax Unit informs appellant that *an examination of his inventory and his records* will prove the correctness of the assessment.

It is also interesting to note that this letter refers to a proposed primary assessment of $5,065.92, whereas the primary assessment actually made was $3,744.74. Mr. Hedrick, agent of appellee, testified that this adjustment was necessary because he originally used as the starting inventory on November 1, 1942, the inventory of the Fillmore Street store instead of the Geary Street store (Tr. p. 251). This further exemplifies the careless approach of the agents in making the assessment.

Furthermore, if appellee knew of concealment of whiskey, then certainly the physical inventory on May 2, 1944, was a useless act since he could not hope to uncover whiskey concealed elsewhere by taking an inventory in the Geary Street store. If appellee knew of the concealment of 200 cases elsewhere, then in the computation of his inventory he would have,

with or without explanation to the taxpayer, merely added these 200 cases to that inventory.

At no point in the appellee's agent's testimony did he testify that he saw or even suspected "200" or any number of cases of "Three Rivers Whiskey" was moved or concealed.

Then again if it were true that appellant concealed 200 cases of 86 proof whiskey, which is 412.8 proof gallons, as is found by the Trial Court, then why does the Trial Court find him guilty of concealing 1222.85 proof gallons? (Finding of Fact No. VI Tr. p. 52).

Typical of the type of investigation allegedly made by the appellee's agents to determine the presence of the 100 cases of Three Rivers Whiskey at the Haight Street store is the following:

In answer to no less than six questions agent Hedrick testified that he *went into* the basement of the Haight Street store looking for whiskey (Tr. pp. 238, 239).

Later, on cross-examination, he stated:

"I don't believe I was in that basement" (Tr. p. 258), and he couldn't even describe the basement (Tr. p. 259).

C. Finding of Fact No. VI Is Contrary to the Evidence and Not Substantiated by the Evidence.

Aside from the oral estimate by appellant that his distilled spirits sales were 86% of his gross sales, there is no other evidence to the correctness or reasonableness of this 86% estimate.

In the face of the following records in this case:

(1) Plaintiff's Exhibits 14 and 17, his permanent records (Tr. p. 181);

(2) The State Board of Equalization Audit (part of Plaintiff's Exhibit 9, in evidence; Plaintiff's Exhibit 21, in evidence);

(3) Appellant's own physical inventory of the Geary Street store (Plaintiff's Exhibit 2, in evidence);

(4) Appellee's physical inventory of May 2, 1944 (Defendant's Exhibit B, in evidence) (each of which records confirms the Floor Stock Tax Return of appellant in this case);

to find that the 86% estimate of appellant is reasonable, is contrary to all the evidence.

With all due respect, appellant cannot follow the reasoning of the Trial Court as to why he found that the 86% figure was reasonable. The Trial Court explained his reasoning in the finding itself (Tr. p. 52). This, in effect, is that it was more favorable to appellant than the 66% estimate originally made by appellant. If we are to accept the logic of the Trial Court that 86% is reasonable because it is more favorable to this appellant than the use of 66%, then the adoption of the 96.41% figure is still more favorable to the appellant and therefore the still more logical figure to adopt.

With reference to the second statement of the Trial Court in Finding of Fact No. VI, to the effect that

the 86% was the most reasonable and rational one "under the circumstances" by reason of the suspicions which the agent had of appellant's activities (Tr. p. 52), we can only conclude the Trial Court did not therefore adopt the 86% figure as a correct percentage figure to use, but merely one which was adopted as a penalty by reason of the alleged suspicious actions of the appellant which came to the attention of the agent. In other words, we have the Court adopting the 86% figure, not on the basis of any actual computation, or actual evidence of correctness (Hedrick testified he never checked it at all) (Tr. p. 273), but purely as a basis for a penalty.

Further, there *is no finding* that the 96.41% figure is correct or incorrect.

In substantiation of appellant's reasoning as to the basis for the Trial Court's opinion, we cite the statement of the Trial Judge in his summation at the conclusion of the case, where he states,

> "But *regardless* of the accounting system, regardless of the percentage figure that *should,* as a synthetic proposition, be employed in an estimate, the overwhelming evidence is at least 200 cases of whisky were shunted somewhere other than to any of the three stores in which Mr. Maroosis was interested." (Tr. 298)

In effect the Trial Court's decision and finding is that he finds that Mr. Maroosis, appellant, is a sinner, therefore he is to be punished for the sins by an arbitrary and baseless assessment.

We have heretofore pointed out the evidence relating to the alleged "shunting" of the 200 cases of Three Rivers Whiskey. It is interesting to note that at no time did any witness testify that any whiskey was at any time found to be at any place other than at the stores of the appellant. It is further interesting to note that not one case of whiskey was ever actually discovered unreported. Nor did appellee attempt to investigate appellant's sales after April 1, 1944, to determine the presence of such a substantial item of 1222.85 proof gallons unreported. This is particularly significant since appellant's return for this store was 1330.36 proof gallons and his alleged shortage of 1222.85 is 94.90% of his return. The underdeclaration represents the equivalent of a complete store inventory.

Assessments must be based on a more firm foundation than the desire of an agent to punish one for alleged suspicious activities.

D. Finding of Fact VII Is Not Supported by Any Evidence and in Effect Legislates a Penalty Greater Than That Imposed by Law.

All of the evidence referred to in this brief is a direct denial of Finding of Fact No. VII (Tr. p. 53) which finds appellant "knowingly, intentionally, and wilfully and deliberately concealed and failed to declare * * * the said 200 cases of whisky * * *."

Appellant respectfully refers this Honorable Court to the law hereinafter cited as to the degree of proof necessary to establish the right to invoke a fraud penalty.

The proof offered as hereinabove set out not only conclusively disposes of the appellee's primary assessment but sustains fully this appellant's original return.

No evidence has proved concealment, let alone intentional or wilful or deliberate or knowing concealment.

Even in the movement of the trucks—this appellant was not named once as having anything personally to do with it. He did not take sole possession of said store until April 1, 1944 (Tr. pp. 68, 69), whereas these truck movements were on March 31, 1944.

The drivers of the trucks have never been connected as agents or employees of appellant. Their names are not even disclosed. The agents saw the truck at a warehouse loading cartons "resembling whisky cartons" (Tr. p. 246). Yet there is no evidence that these agents even made inquiry of the warehouse as to what said truck took therefrom. The truck which the agent followed to the San Bruno Avenue address was never connected with the concealment of any whisky. The large truck was never followed to any ultimate destination where whisky was removed, stored or concealed, but was lost in the traffic (Tr. p. 249). Not one bottle of liquor was proved concealed. *Furthermore the record is barren of any evidence showing that appellee's agents ever questioned appellant with regard to the alleged movement of goods on March 31, 1944. One can only conclude that appellee was far more satisfied to end his investigation with*

his suspicions unconfirmed, than he was to continue his investigation to an ultimate conclusion. Not one proof gallon was proved to be underdeclared. Yet a fraud penalty is invoked. It is a dangerous practice and one which strikes at the very fundamentals of the principles of taxation and those of enforcing penalties for fraud.

Aside from the failure of the proof to support this finding, we have the court finding appellant concealed 200 cases of Three Rivers Whiskey. As heretofore pointed out, this is 412.8 proof gallons. The primary assessment was on a 1222.85 proof gallons under-declaration. Hence, by finding a shortage of 412.8 proof gallons and approving a primary assessment and ad valorem penalty of 50%, the Trial Court in effect is approving a 300% primary assessment and 300% ad valorem penalty.

IV. APPELLANT HAS, BY A PREPONDERANCE OF THE EVIDENCE, PROVED THAT THE PRIMARY ASSESSMENT IS ILLEGAL.

In our discussion of the law with regard to arbitrary and excessive assessments, we refer to a number of decisions rendered by the United States Tax Court. We are fully aware that this is a Court of lower jurisdiction than the United States Circuit Courts of Appeals, and we do not cite these decisions with the idea that they are binding in any manner on this Court. However, the logic of these decisions is of compelling interest. Furthermore, the decisions

of the United States Tax Court discussed in our brief cited *Helvering v. Taylor,* 293 U.S. 507 for their authority.

The leading case on the subject of arbitrary assessment seems to be *Helvering v. Taylor, supra.* The Court at page 515 stated:

> "But, whereas in this case the taxpayer's evidence shows the commissioner's determination to be arbitrary and excessive, it may not reasonably be held that he is bound to pay a tax that confessedly he does not owe, unless his evidence was sufficient also to establish the correct amount that lawfully might be charged against him. On the facts shown by the taxpayer in this case, the Board should have held the apportionment arbitrary and the commissioner's determination invalid."

Various decisions support the principle set down in *Helvering v. Taylor, supra.*

In *Frank MacDonald,* Paragraph 44,363 P-H Memo TC, the taxpayer was engaged in the business of placing bets on horse races. His accountant kept a book record setting forth the amount won or lost on the day's transactions. The taxpayer testified the record was correct. Petitioner's books showed a gain from the business in an amount of $1,990.75 for the year. The total amount bet during the year was $119,529.00.

The Bureau of Internal Revenue added $9,964.00 to the income of the taxpayer, after an audit of his return, resulting in an adjusted net income of $11,-971.60. The Government contended that at Pari

Mutuel Racing Tracks 10% of bets was taken out for the Racing Association and that therefore it was assumed taxpayer made the same profit, and assessed him accordingly. The Government contended that daily slips of each bet should have been maintained by the taxpayer. The taxpayer admitted that the slips of each daily bet had been destroyed so that they could not be used as evidence against him on a bookmaking charge. The Court held for the taxpayer and said on page 1300:

> "The petitioner has testified under oath that the daily slips made out by him for the year 1941 and received in evidence and the books kept by his accountant reflecting his transactions accurately and truthfully represent his gains upon his business.
>
> "There is no claim made by the respondent that his action in the determination of a deficiency in income tax was not entirely arbitrary. He has simply assumed that the petitioner must have made a profit of at least ten per cent upon the gross bets placed with him.
>
> "Although the respondent's determination is prima facie correct and the burden of proof that it is incorrect is on the petitioner, we think that the petitioner has borne this burden of proof; we cannot assume, without any proof whatever, that a person engaged in such a business as the petitioner was engaged in has a profit of at least 10% upon bets placed with him. His sworn statement is that the net profits received by him from his horse racing business in 1941 were $1,990.75. This is in accordance with the book records kept."

The case of *W. L. Harris,* 7 T.C.M. 820, Dec. 16,-688 (M), presented many of the points raised in the case at bar.

The petitioner was assessed on income tax deficiencies and penalties. He was a dentist who was also engaged in other diversified activities. He had five bank accounts, and deposits were shifted from one to another. Various proceeds from bank loans also cleared through these accounts. Questioned by Internal Revenue Agents, the petitioner advised them that he paid his dental supply bills half by cash and half by check. The agent secured a signed statement from petitioner as follows:

> "About half of my entire receipts are paid out in cash that is never deposited in the bank. The other half of my receipts are deposited. I do not keep any book records. The only record I keep is a card record for my dental income. Book records are kept for the hotel operation."

Petitioner's income was then determined by the agent who relied on this signed statement.

The Court held at p. 826:

> "Although the petitioner's records may have been 'inadequate' for precise and complete verification of his returns, this fact does not justify the respondent in determining income upon a basis which is plainly not consistent with the surrounding circumstances, and which give results absurd upon their face. The determination was without rational foundation and was arbitrary and excessive. Helvering v. Taylor, supra."

The Court also at p. 826 pointed out that it was the duty of the agent to have made further inquiry from the bank officials and others relative to loans and other proceeds and then stated:

> "Furthermore, the agent found no evidence whatever, nor was any adduced before us, that the petitioner had expended or now possesses any such sums as he is charged with receiving. The petitioner still owes over $18,000, secured by liens on his property."

In our case appellant has pointed out that he is charged with possession of 1222.85 proof gallons of distilled spirits on which he allegedly failed to report. Appellee, by his own spot check and physical inventory of May 2, 1944, admits there was not one proof gallon in appellant's store which he failed to report.

Appellee has failed to establish any concealment or that since April 1, 1944, appellant sold or possessed any distilled spirits not reported by him.

The case of *Arthur Ward,* 7 TCM 505, Dec. 16,523 (M), involved a taxpayer in the retail liquor business. The taxpayer kept a set of single entry records. The agent concluded that they were inadequate. The Bureau of Internal Revenue re-computed the taxpayer's income tax on a gross profit basis using the mark-up allowed liquor dealers by the State of South Carolina during the years in issue.

The petitioner insisted that the computation by the Bureau of Internal Revenue was based on false

assumptions, and was arbitrary and excessive. The evidence showed that he could not sell the liquor at the mark-up permitted by the state; that he had to buy four or five cases of off-brand merchandise in order to get one case of standard merchandise; and that the less desired liquors were sold at much smaller mark-up, sometimes even at a loss. The Court found for the taxpayer, and said on page 506:

> "The petitioner's evidence shows that he could not have realized the profit assumed by the respondent as the basis of the deficiencies determined. Although the records may have been inadequate for the verification of the returns, this fact does not authorize the respondent to determine the income upon a basis which is plainly not consistent with the surrounding circumstances. The determination was without rational foundation and was excessive. As such, it will not be enforced. Helvering v. Taylor, 293 U.S. 507 (35-1 U.S.T.C., par. 9044)."

The case of *Williams Stratman,* par. 49,143 P-H Memo T.C., involved a taxpayer who conducted a tavern. The facts showed that the taxpayer's knowledge of methods of bookkeeping was inadequate. The only record he kept was a small journal in which he entered readings of the cash register. The agent for the Bureau of Internal Revenue determined the income of the taxpayer on the basis of the average mark-up of other taverns in the same town.

However, the evidence of the petitioner showed that he followed a liberal policy of giving free drinks to

customers, that he did not require deposits on beer cases, even though he was charged $1.25 per each case, and that failure to return the cases would considerably reduce his profits. Furthermore, the petitioner extended credit in the taxable years, and debts of at least $400.00 incurred at that time were still outstanding. Further, drinks were priced below OPA limits. The Court said on page 486:

> "The preponderance of the evidence satisfies us that petitioner's mark-up was so low, and that his operations were so unbusinesslike, consistent as they were with his apparent incapacity to cope with the problem of keeping the business books, that they resulted in large discrepancies between amounts he should have received, even on the basis of a moderate mark-up, and amounts actually collected. Whether we say that the evidence convinces us that there is no deficiency, or that at least petitioner has made a sufficient showing to shift the burden of going forward to respondent, see Kern v. Poe, (D.C.), 8 Fed. Supp. 942 (14 A.F.T.R. 1065); B. F. Edwards, 39 B.T.A. 735, Acq. 1939-1 C.B. 11, the conclusion remains as set forth in our findings, that on the record before us, petitioner had no net income from his tavern, and that accordingly his failure to report any was consistent with his actual operations."

The Court further said on page 486:

> "We do not have to say here, as was held in Helvering v. Taylor, 293 U.S. 507 (14 A.F.T.R. 1194), that respondent's determination of the deficiency in controversy was arbitrary, and that as

a consequence no burden rests upon petitioner to demonstrate with exactitude the income which he did receive. See Wolder, 'Limitations on the Commissioner's Power,' Taxes, January 1949, pp. 22, 25. But we are satisfied that by the methods used respondent arrived at an excessive figure, and that petitioner's mark-up was not even in the general neighborhood of that employed by the Revenue Agent. See G. A. Miller, 6 B.T.A. 401."

The case of *United States v. First Wisconsin Trust Co.,* (C.C.A. 7) 92 F. (2d) 840, was brought to recover taxes illegally assessed and collected. The Government sought to introduce evidence to the effect that the taxpayer had received certain income that had not been reported. However, there had been no pleading by the Government defendant as to those facts.

The Government contended that no special pleading was necessary, on the theory that the plaintiff taxpayer, in order to recover the tax paid, has the general burden of proving himself not indebted to the Government. The Court, rejecting this argument, held on page 845:

"Of course, Government's counsel did not intend to mislead the court by stating that the proffered amendment raised no issue. His contention was, and is now, that the issue specifically raised by the last amendment was present *ab initio,* and that it was really unnecessary for the government to plead it specially. In other words, it contends that the burden was upon appellees in the first instance to prove that their decedent was not otherwise indebted to the Govern-

ment before they could recover the erroneous payment for which they sued, in case such payment was found to be erroneous. We think this contention is not supported by reason or authority. In Helvering v. Taylor, 293 U.S. 507, 55 S.Ct. 287, 290, 79 L.Ed. 623, the court said:

"'We find nothing in the statutes, the rules of the board or our decisions that gives any support to the idea that the commissioner's determination, shown to be without rational foundation and excessive, will be enforced unless the taxpayer proves he owes nothing or, if liable at all, shows the correct amount * * *.'"

The case of *In re Schwann, U.S. v. Irving Trust Co.,* (CCA-2) 82 F. (2d) 160 involved the estate of a bankrupt. The referee made an order directing the United States to file proof of its claim within thirty days. After the thirty-day period, the claim was filed. The trustee moved to expunge the claim on the ground that it was filed too late and that the assessment was arbitrary and unwarranted. The Judge of the District Court held the bar order would be lifted, if the Government could show that their claim had merit, but since no merit was shown, the bar order stood. The Circuit Court of Appeals held that the bar order would stand on grounds not pertinent to the present action, but, commenting on the assessment, the Court held at page 161:

"When the government produced the assessment list, it had shown a prima facie right to have the bar order removed—a right which apparently was only controverted by oral assevera-

tions of the trustee's attorney. It may be that upon such a record, the referee ought to have removed the bar and to have tried out the claim on the merits and that Judge Coxe should have sent back the case to the referee for trial rather than for further consideration as to the removal of the bar. But no attempt was made to review the order of Judge Coxe under section 24b of the Bankruptcy Act, and the appellant produced as a witness the very man on whose investigation the assessment was made. His testimony showed that the assessment was a mere 'shot in the dark' having no foundation. In other words, the government's testimony overcame the presumption in its favor, and demonstrated that the assessment was arbitrary. Helvering v. Taylor, 293 U.S. 507, 515, 55 S.Ct. 287, 79 L.Ed. 623.

We suggest the above only to indicate that in our opinion the appellant lost nothing by its inability to remove the bar."

Louisville Provision Co. v. Glenn, District Court, W.D. Kentucky, 18 F. Supp. 423, involved a taxpayer who sought to enjoin an assessment of taxes. The Court held that it could not grant an injunction against the proposed assessment of taxes, but in pointing out the various remedies available to a taxpayer in cases of an illegal assessment of taxes, said at page 431:

"The taxpayer could then appeal to the Board of Tax Appeals, and a trial be had without the payment of any tax. The Commissioner of Internal Revenue would be required to find a fact basis for the determination of a deficiency, which,

> if arbitrary and without support would be void. Helvering v. Taylor, 293 U.S. 507 * * *."

The importance of this statement of the Court cannot be underestimated. There must be a "fact basis" to a determination of a deficiency. A deficiency not based on facts but arrived at in a purely arbitrary manner is illegal and void.

In the case of *Simon Bloom,* 7 TCM 517, Dec. 16,529 (M), the court summarized the status of the law on the subject of arbitrary assessments by the Bureau of Internal Revenue. The taxpayer had reported gross income from the sale of narcotics. The taxpayer testified that he had lost the record on which said sales were listed. The Commissioner increased the gross income based on an estimate of daily sales. The Commissioner attempted to justify the assessment merely by the inadequacy of $2310.00 to cover petitioner's known expenses and probable living requirements. $2310.00 was the amount available to the petitioner based on his reported income. The Court, holding for the taxpayer, summarized the law on the subject of arbitrary assessment on page 518 as follows:

> "If a taxpayer keeps no records or if those kept fail to reflect income correctly, a computation may be made in accordance with such methods as in the Commissioner's opinion does truly reflect income. Section 41, Internal Revenue Code; Bishoff v. Commissioner (C.C.A. 3rd Cir.) 27 Fed. (2d) 91 (1 U.S.T.C. par. 301). And in many such cases a computation based on a dis-

closed annual increase in wealth has received judicial approval as a measure for taxable receipts. Hoefle v. Commissioner (C.C.A. 6th Cir.) 114 Fed. (2d) 713 (40-2 U.S.T.C. Para. 9763); O'Dwyer v. Commissioner (C.C.A. 5th Cir.) 110 Fed. (2d) 925 (40-1 U.S.T.C. par. 9371); Lewis Halle, 7 T.C. 245 (Dec. 15,243). In some cases estimated living expenses have been approved as a proper addition to the increase in wealth so treated. Kenny v. Commissioner (C.C.A. 5th Cir.) 111 Fed. (2d) 374 (42-1 U.S.T.C. par. 9207); Joseph Calafato, 42 B.T.A. 881 (Dec. 11,-327) aff'd. (C.C.A. 3rd Cir.) 124 Fed. (2d) 187 (40-1 U.S.T.C. par. 9272). In all such cases, however, the determination approved was based on the Commissioner's ascertainment that the taxpayer held cash, bank accounts, securities or other property at the end of the year in excess of what he had held at the beginning. It was the taxpayer's failure to account for these increments in wealth which the courts stressed in sustaining this treatment of them as taxable income. As said in Estate of Hague v. Commissioner (C.C.A. 2nd Cir.) 132 Fed. (2d) 775 (43-1 U.S.T.C. par. 9258), cert. den. 318 U.S. 787: '* * * The determinations of the Commissioner were based on inferences properly drawn from the facts proved by the evidence, and were therefore entitled to be accepted as prima facie correct * * *.'

"The Commissioner's determination here, however, lacks the support of any ascertained facts or inferences indicating receipts in excess of the gross income reported * * *. The Commissioner, in the deficiency notice, by his evidence and on briefs, does not purport to have based his addi-

tion to income on any ascertained finding of receipts, and attempts to justify it merely by the inadequacy of $2,310 to cover petitioner's known expenses and probable living requirements. We think that such a determination was arbitrary and should not be approved (Cf. Helvering v. Taylor, 293 U.S. 507 (35-1 U.S.T.C. par. 9044)). The record establishes that petitioner and his wife lived frugally. There are not even extravagant expenditures to support inferences of unexplained receipts. The determined addition of $1,268 to income therefore is not sustained."

V. APPELLEE HAS FAILED TO PROVE FRAUD BY CLEAR AND CONVINCING OR ANY EVIDENCE.

As heretofore pointed out, the appellee's evidence on appellant's alleged fraud was based entirely on the unfounded suspicions of the agent. The primary assessment itself, in appellant's opinion, was arbitrary and unwarranted. Under the law hereinafter cited, it is respectfully submitted that appellee wholly failed to establish facts warranting the fraud penalty.

Just as the law cloaks every man with a presumption of innocence, it likewise cloaks him with a presumption of good faith in his business dealings. Fraud is never presumed in a tax case. Fraud must be proved by clear and convincing evidence, and the burden of proof is on the Commissioner of Internal Revenue.

Duffin v. Lucas, (C.C.A. 6) 55 F. (2d) 786,
Budd v. Commissioner of Internal Revenue, (C.C.A. 3) 43 F. (2d) 509,

Henry S. Kerbaugh, 29 B.T.A. 1014, affirmed 74 F. (2d) 749,
A. W. Mellon, 36 B.T.A. 977,
Jennison v. Commissioner of Internal Revenue, (C.C.A. 5) 45 F. (2d) 4,
Griffiths v. Commissioner of Internal Revenue, (C.C.A. 7) 50 F. (2d) 782,
Morris, par. 42,231 P-H Memo B.T.A.,
A. W. Minyard, par. 47,283 P-H Memo T.C.
M. W. Primm, par. 45,078 P-H Memo T.C.

In *Duffin v. Lucas, supra,* the court said on page 798:

"* * * In appropriate cases there is a presumption that the commissioner's action was rightful; but it is a fundamental rule of judicial procedure that fraud cannot be lightly inferred but must be established by clear and convincing proof. It may well be that the right to due process would be infringed by a rule of procedure which abolished this fundamental principal and authorized a finding of fraud—at least, if involving a felony—to be based on that minimum called 'any substantial evidence.' Certainly, as we think, in a suit to recover back such a penalty, the general assumption that the commissioner was right has no evidential effect of itself sufficient to support a judgment affirming the penalty, its effect being procedural only; and the rule that a finding of fact by the judge in the District Court will be affirmed by us if there is any substantial evidence to support it, *does not avail* to sustain such finding of fraud if we conclude that the proof relied upon is insufficient in law to be rightfully regarded as clear, convincing or satisfying."

In *Henry S. Kerbaugh, supra,* the court said at page 1015:

> "* * * the burden of proving fraud in civil cases has always been held to be on him who asserts it. It is never presumed."

In *Jennison v. Commissioner of Internal Revenue, supra,* the court said on p. 5:

> "* * * However, the presumption does not extend to his determination that the taxpayer was guilty of fraud in filing his return. Fraud is never to be presumed but must be determined from clear and convincing evidence, considering all the facts and circumstances of the case."

In *A. W. Minyard, supra,* the court said at p. 960:

> "We are not unmindful here of Petitioner's failure to prove the source of a large part of the income, particularly the $18,000 alleged to have been received from Allen, or our finding, in part, for the respondent. That finding was based upon the presumption of correctness of the Commissioner's determination and failure of proof by petitioner to overcome it. His failure in that regard does not relieve respondent of his full burden of proving that the deposits of money constituted income in 1944, the failure to report which was due to fraud with intent to evade tax. Considering petitioner's habits of withholding from deposit to accounts in banks, amounts of currency commencing in 1918, mere proof of such deposits in 1944 does not meet the requirement of affirmative, clear and convincing proof of fraud by the respondent, or raise a presumption that the money was earned in 1944—and we have re-

frained from so holding, our conclusion as above stated being based on failure of proof."

In *M. W. Primm, supra,* the taxpayer was an official of the Works Progress Administration. The Government contended that the taxpayer owned a construction company and was taxable on the profits of that company. The taxpayer contended he had merely made loans to the company and did not own any interest in the company. The witnesses for the Government testified that the taxpayer as an official of the WPA could not legally or ethically have an interest in a construction company entering into contracts with the WPA. They further testified to the fact that the taxpayer desired to have an interest in a construction company, and a key witness for the Government testified that the taxpayer told him, prior to the formation of the business in question, that he (the taxpayer) intended to own such a business in the name of another person. However, the Government was unable to trace any of the income of the business into the possession of the taxpayer. Based on this evidence, the commissioner not only assessed the taxpayer on the income of the business but also asserted a fifty percent fraud penalty. The Court on p. 290 said, with regard to the testimony that the taxpayer *intended* to own the business in the name of some other person:

"* * * The witness did not profess to know whether the plans discussed were ever given effect, and we are not free to assume that they were in view of Primm's flat denial, the uncer-

tainty of the witness with respect to the time and circumstances surrounding the incidents about which he testified * * *."

The Court said on p. 289:

"* * * on the issue of fraud the burden rests on respondent to prove by clear and convincing evidence not only that petitioner had income which he did not report but that his failure to report it was with intent to evade tax. See Duffin v. Lucas (C.C.A. 6th Cir.) 55 Fed. 2d 786 (10 A.F.T.R. 1167, certiorari denied 287 U.S. 611, and Griffiths v. Commissioner (C.C.A. 7th Cir.), 50 Fed. 2d 782 (10 A.F.T.R. 106)."

The court said further on p. 289:

"The record is devoid of any evidence that during the years in question, Primm received and did not report taxable income from the construction equipment business * * *."

The cases above cited and discussed clearly establish that the appellee in the instant case has the burden of proving by clear and convincing evidence that the plaintiff filed a fraudulent return.

What is clear and convincing evidence?

Black's Law Dictionary, on page 337, defines clear and convincing proof as follows:

"There are numerous variations of the phrase 'clear and convincing' as applied to proof, such as 'clear and distinct,' 'clear, distinct and satisfactory,' 'clear, precise and indubitable,' 'clear and satisfactory,' 'clear, cogent and convincing,' etc. Generally, they mean, when applied to

proof, proof beyond a reasonable, i.e. a well-founded doubt, though, of course, the evidence may be conflicting and absolute certainty is not required (citing various cases). There are cases, however, that give a less rigorous but somewhat uncertain meaning, viz., more than a preponderance but less than is required in a criminal case (citing various cases)."

In the cases cited above on the necessity of clear and convincing evidence to support a fraud penalty, the Court did not in any of these cases define the term "clear and convincing." However, these cases do indicate that the burden placed upon the Commissioner when he alleges fraud is equivalent to the burden placed upon any party in a controversy who alleges fraud. In the case of *In re Locust Bldg. Co. Inc.* (C.C.A. 2), 299 Fed. 756, the Court said at p 765:

"The general rule is that fraud must be made out by a preponderance of evidence, which should be so clear and strong as to preponderate over the general and reasonable presumption that men are honest and do not ordinarily commit fraud or act in bad faith. 27 C. J. 62. And in Wigmore on Evidence, Vol. 4, par. 2498, alluding to the rule that in civil cases a preponderance of the evidence is sufficient, he states that a stricter standard is applied in cases of fraud. He says: 'But a stricter standard in some such phrase as "clear and convincing proof" is commonly applied to measure the necessary persuasion for a charge of fraud,' and in a few related classes of cases.

"As was said in Jones v. Simpson, 116 U.S. 609, 615, 6 Sup. Ct. 538, 29 L.Ed. 742, the law pre-

sumes, in the absence of evidence to the contrary, that the business transactions of everyone are carried on in good faith, and anyone who alleges that such acts are done in bad faith, or for a dishonest or fraudulent, purpose, takes upon himself the business of showing the same * * *."

The Court said further on page 766:

"In Farrar v. Churchill, 135 U.S. 609, 615, 10 Sup. Ct. 771-773 (34 L.Ed. 246), the Court said: 'Fraud is never presumed, and where it is alleged, the facts sustaining it must be clearly made out.'

"In Lalone v. United States, 164 U.S. 255-257, 17 Sup. Ct. 74, 75 (41 L.Ed. 425), the Court, referring to proceedings to set aside deeds or other written instruments on the ground of fraud practiced by defendant upon a plaintiff, said that: 'The rule is of long standing and is of universal application, that the evidence tending to prove the fraud * * * must be clear and satisfactory. It may be circumstantial, but it must be persuasive. A mere preponderance of evidence, which at the same time is vague or ambiguous, is not sufficient to warrant a finding of fraud and will not sustain a judgment based on such finding.' "

In *Tucker v. Moreland,* 35 U.S. 58, the Supreme Court of the United States said at page 78:

"Fraud is never presumed, either as a matter of law or fact, unless under circumstances not fairly susceptible of any other interpretation."

The appellee's evidence in the instant case falls far short of meeting the requirements of the well established rule that clear and convincing evidence is required to establish fraud.

CONCLUSION.

Because, as is set forth in this brief, and from the records and evidence in this case, the primary assessment herein referred to was arbitrary and excessive; because the acceptance by the agent of appellant's estimate that 86% was the correct percentage of his distilled spirits sales against gross sales without checking said estimate or auditing appellant's books; because, from appellant's permanent books and records all information could be gleaned necessary to determine the correctness of appellant's April 1st, 1944 physical inventory; because the actual audit by the State Board of Equalization determined that 96.41% was the actual percentage of distilled spirit sales against gross sales; because appellee, without checking said State Board of Equalization audit, ignored it completely; because appellee alleged in his answer that his own May 2, 1944 physical inventory was erroneous because of omissions and errors in appellant's records, and failed to prove such errors and omissions, but instead contended on the trial that its May 2, 1944 physical inventory was erroneous because of an alleged concealment of distilled spirits by appellant; because such alleged concealment was not proved but was based entirely upon irrevelant and unsupported

suspicions; because appellee failed to prove the concealment of any whiskey by appellant; because various Findings of Fact as herein set forth are unsupported by the evidence and contrary to the evidence; because, by stipulation, appellee has, in effect, admitted his primary assessment is in error; because appellee admitted, though such admission is unwarranted, that he can not at this time nor could he prior to the trial, determine appellant's true and correct inventory as of April 1st, 1944; and finally, because appellee has utterly failed to sustain his burden of proving fraud by clear and convincing evidence, it is respectfully submitted that the judgment herein entered must be reversed.

Dated, San Francisco, California,
August 28, 1950.

Respectfully submitted,
MORRIS M. GRUPP,
LEON SCHILLER,
Attorneys for Appellant.

(Appendices A and B Follow.)

Appendices A and B.

Appendix A

SCHEDULE I.

COMPUTATION OF DISTILLED SPIRIT SALES BY STATE BOARD OF EQUALIZATION

Per Plaintiff's Exhibit 21, Page 1

Beginning Inventory—6/30/43	$ 5,912.24
Purchases	174,772.73
	$180,684.97
Less Inventory—5/25/44	18,827.22
	$161,857.75
Floor Tax Paid	3,991.09
	$165,848.84
Gross Profit	55,282.86
Distilled Spirit Sales (Exclusive of Sales tax)	$221,131.70
Sales Tax	5,528.29
Distilled Spirit Sales (Including sales tax)	$226,659.99

The purchase figure of $174,772.73 is supported by the appellant's records as follows:

Plaintiff's Exhibit 14
Caption—"Invoice Register"
Column—"Distilled Spirits"

Month	Page	Amount
July, 1943	36-A	$ 6,378.51
August	38	7,730.91
September	40-A	9,778.22
October	42-A	7,733.71
November	44-A	16,222.39
December	46-A	71,533.45
January, 1944	47-A	18,499.63
February	48-A	24,780.70
March	49	4,926.34
April	50	21,927.69
May	51	2,698.19
May	51	89.32
	Total	$192,299.06

Total (Determined by State Board—which total is $119.81 less than above)		$192,179.25
Less:		
Freight charges classified as purchases		
S.F. Warehouse (March, 1944—Page 49)	$ 54.25	
Transport Clearings (March, 1944—Page 49)	115.18	
S.F. Warehouse (March, 1944—Page 49)	108.25	
Manhattan Mountain Lines (April, 1944—Page 50)	57.68	
S.F. Warehouse (May, 1944—Page 51)	21.00	356.36
		$191,822.89
Less:		
Merchandise transferred from the Geary Street Store to the Fillmore and Haight Street Stores		
Plaintiff's Exhibit 14		
Caption—"Journal"		
Third page counting back from the caption "Assets"		
Transferred to Haight Street Store	$ 4,735.40 A	
Transferred to Fillmore Street Store	15,658.40 A	
		20,393.80
		$171,429.09

Note (A)—Exhibits 12 and 13 (plaintiff) are transfer sheets setting forth the specific merchandise transferred from the Geary Street store to the Fillmore and Haight Street stores.

Add:	
Merchandise transferred to the Geary Street Store From the Mission Bar Plaintiff's Exhibit 14 Caption—"Journal" Third page counting back from the caption "Assets"	
The Journal entry shows that $1020.34 merchandise was transferred from the Mission Bar to the Geary Street store. Apparently $49.32 of this merchandise was not distilled spirits because Plaintiff's Exhibit 21 shows that distilled spirits transferred were in the amount of	971.02
	$172,400.11
Add:	
Credit memorandum not applicable to distilled spirit purchases between July 1, 1943 and May 25, 1944, but entered as a credit in December, 1943 Plaintiff's Exhibit 14 Caption—"Invoice Register" Column—"Distilled Spirits" December, 1943—Page 46 (A)	2,372.62
Purchases of Distilled Spirits—Per State Board Audit	$174,772.73

After adding the opening inventory of $5,912.24 to the purchases of $174,772.73, the State Board subtracted the distilled spirits inventory at May 25, 1944 in the amount of $18,827.22. Exhibit 11 (plaintiff's) is the typed recapitulation of the appellants' inventory of the Geary Street store on May 25, 1944. On Page 1 of said Exhibit the following items appear:

Whiskey, Gin, Rum, Scotch, Brandy	$ 14,973.19
Liqueur	3,854.03
	$ 18,827.22

These two items are the only distilled spirits in this inventory.

The next item the State Board considered was the floor tax paid. Paragraph VIII of the complaint (Transcript, p. 6) alleged that the appellant reported an inventory of distilled spirits for the Geary Street store in the amount of 1,330.36 proof gallons. Paragraph VIII of the answer (Transcript, p. 21) admits the truth of the allegation. The rate of floor tax was $3.00 per proof gallon and $3.00 multiplied by 1,330.36 equals $3,991.09.

The State Board then added 33⅓% mark-up, the mark-up accepted by all parties to this controversy as the correct mark-up.

The next figure is $5,528.29 California sales tax which represents 2½% of $221,131.70.

Appendix B

SCHEDULE II

EXCERPTS FROM PLAINTIFF'S EXHIBIT 7 IN EVIDENCE

"Records of sales to you by dealers from whom you purchased distilled spirits and other records examined during investigation show that the total distilled spirits which should have been declared by you amounted to 3414.25 proof gallons which resulted in a net underdeclaration of distilled spirits tax of $5,-065.92. This underdeclaration of tax amounted to approximately 50% of the entire amount of tax which should have been declared and cannot be justified as due to error, oversight, or circumstances beyond your control. Therefore, penalty of 50% of the amount of the tax was recommended for assessment, and assessment was made of this penalty as provided for in Section 3612(d)(2) Internal Revenue Code.

"It is presumed that upon receipt of the notice of assessment of tax on Form 17-B that you have reexamined the copy of the inventory retained at your premises. Such examination and examination, also, of your records of purchases and sales of distilled spirits, whether stored on your premises or held by you in storage elsewhere, should reveal correctness of the amount of tax due."